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SUBJECT: BELGIUM REGISTERS FIRST BUDGET DEFICIT IN EIGHT YEARS; 2008 MAY BE WORSE

¶1. (U) Belgium registered its first budget deficit since 1999 for the year 2007. The deficit came in at a level of 0.3% of GDP, or 260 million euros (USD 390 million). GDP for year was 80 billion euros (USD 120 billion), up 2.7 %. Economic growth is expected to slow to 2.1 % in 2008 and the budget deficit is expected to worsen as the new government implements its spending priorities.

¶2. (U) Vice Prime Minister and Budget Minister Yves Leterme stated at the beginning of January that reducing this deficit during his current term as minister (which runs until March 23 pending installation of a permanent government) is his number one priority.

¶3. (U) Analysts attribute the first budget deficit in eight years to several factors. High oil prices, uncertainty over the exposure of Belgian banks and investors to the subprime crisis, and the strong euro helped depress expected economic growth. Belgium's tax authorities collected 900 million euros (USD 1350) in tax revenues less than in 2006. In addition, the lack of a government for much of the year prevented the final sale of a number of government assets which would have helped increase revenues. Ironically, other analysts believe the lack of a central government helped reduce the deficit because the provisional government was working under the equivalent of a continuing resolution.

¶4. (U) One well-informed academic observer of the government's finances admitted noted that the small size of the deficit was more worrisome than at first analysis. This was because the government had planned to continue with a series of budget surpluses in order to prepare for the aging of the Belgium population and strengthen the social safety net. He also attributed much of the deficit to the notional tax facility put in place by the Belgian government in 2007. Under this scheme, an investor is allowed a tax deduction for risk capital equal to a certain percentage of their net equity (capital and reserves) located in Belgium. (NOTE: The notional tax deduction has helped Belgium attract subtract inflows of foreign investment in 2007. END NOTE).

¶5. (U) Belgium's three regions and its communities continued to register surpluses in 2007, especially in Flanders. The deficit, therefore, was due solely to the federal government.

¶6. (SBU) COMMENT: For the moment it does not appear that Belgium's on-going government formation crisis affected economic growth or foreign direct investment in 2007. Indeed, the notional interest deduction appears to be more

than sufficient to continue to attract foreign investment to Belgium. However, the notional interest deduction certainly hit the government's tax revenues.

¶7. (SBU) COMMENT (Cont.): As for reducing the budget deficit in 2008, the government will be hard-pressed. Economic growth is expected to continue to slow and no one is talking about ending the notional interest deduction. Furthermore, many of the easy moves have already been made and there are no more opportunities to take over pension funds or sell government buildings, moves which papered over cracks in the fiscal picture over the previous eight years. The government, or its successor, will continue to confront critical decisions on the roles of the federal government and the regions in Belgium as well as looming regional elections in 2009. Making the difficult decisions needed to reduce the deficit, let alone register a surplus, will be a supreme challenge.
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